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Case at a Glance

Section 106 of the Bankruptcy Code abrogates a state's sovereign immunity in bankruptcy. A debtor filed a complaint in bankruptcy court against the state of Tennessee to discharge her student loans. Tennessee claims that § 106 of the Bankruptcy Code violates the Eleventh Amendment, which protects a state's sovereign immunity.

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ISSUE

Does Congress have the authority to abrogate state sovereign immunity under the bankruptcy clause of the United States Constitution?

FACTS

Between July 1988 and February 1990, Pamela Hood, the respondent in this case, signed promissory notes for student loans guaranteed by the petitioner, the Tennessee Student Assistance Corporation ("the state" or "TSAC"). TSAC is a governmental corporation created by the Tennessee legislature to administer student assistance programs and authorized by law to guarantee student loans under the provisions of the Federal Higher Education Act of 1965.

On February 26, 1999, the debtor filed a "no asset" Chapter 7 bankruptcy in the United States Bankruptcy Court for the Western District of Tennessee. Sallie Mae Service, Inc. submitted a proof of claim to the bankruptcy court, which it subsequently assigned to TSAC. TSAC, however, never filed a proof of claim in the bankruptcy case.

Respondent received her general discharge on June 4, 1999, without addressing her student loans. She subsequently reopened the case on September 14, 1999, and on October 14, 1999, she filed a complaint in bankruptcy court seeking a hardship discharge under 11 U.S.C. § 532(a)(8). She named the United States of America, its Department of Education and Sallie Mae, as defendants. On February 22, 2000, the debtor amended her complaint to add TSAC as a defendant. At the time she filed the complaint, the debtor owed the state $4,169.31.

The state moved to dismiss the complaint, arguing that the bankruptcy court did not have jurisdiction over TSAC based on its sovereign immunity as a state agency. Following a hearing, the bankruptcy court denied the state's motion. *In re Hood*, 2000 WL 33965623 (Bankr. W.D.Tenn. 2000). The bank-

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ruptcy court found that TSAC was a state agency entitled to assert the protection of sovereign immunity under the Eleventh Amendment, but that Congress validly abrogated that immunity when it enacted 11 U.S.C. § 106(a).

The state appealed to the United States Bankruptcy Appellate Panel ("BAP") for the Sixth Circuit, which affirmed the bankruptcy court's decision. *In re Hood*, 262 BR 412 (6th Cir. 2001). The panel concluded that the states ceded their sovereignty over the bankruptcy discharge, as a part of the plan of the Constitutional Convention and that, where there is no sovereignty, there can be no sovereign immunity. On the state's appeal, the court of appeals affirmed the decision. *In re Hood,* 319 F.3d 755 (6th Cir. 2003).

The Sixth Circuit ruled that Congress validly abrogated the states' sovereign immunity through the exercise of its power under the Bankruptcy Clause, U.S. Const. art. I, § 8, cl. 4, because the states, in ratifying that provision, had already agreed to surrender their immunity with respect to bankruptcy laws. In reaching this decision, the Sixth Circuit relied on its interpretation of The Federalist Papers, notably Nos. 32 and 81. Based on its reading of those two essays, the court found that there was no other conclusion than that there had been a waiver of the states' immunity in the plan of the convention with respect to bankruptcy cases when the states granted Congress power to make uniform laws on the subject. The state appealed to the Supreme Court, and certiorari was granted. *Tennessee Student Assistance Corporation v. Hood*, 124 S.Ct. 45 (2003).

Case Analysis

The Eleventh Amendment provides that "the judicial power of the United States shall not be construed to extend to any suit commenced against one of the United States." The Eleventh Amendment presupposes that each state is a sovereign entity in our federal system and, by virtue of its sovereignty, not amenable to suit by an individual without its consent. However, Congress may abrogate a state's sovereign immunity provided it has acted pursuant to a valid exercise of power. The issue here is whether Article I's Bankruptcy Clause is sufficient authorization for Congress's passage of § 106 of the Bankruptcy Code, which abrogates a state's sovereign immunity in bankruptcy.

Petitioner TSAC asserts that the powers allocated to Congress by Article I of the Constitution to legislate on the topics specified therein do not include the power to create private rights of action against unconsenting states. The states' immunity from private-party suits is based on the precepts that each state is a sovereign entity in our federal system, and that it is inherent in the nature of sovereignty not to be amenable to suits brought by an individual without the sovereign's consent. Petitioner believes that state immunity fundamentally limits Article I. Thus, Congress may not use its Article I powers to abolish that immunity, regardless of the breadth of the Article I powers.

TSAC maintains that this case is squarely controlled by the Supreme Court's recent decision in *Seminole Tribe of Florida v. Florida*, 517 U.S. 44 (1996). In *Seminole Tribe*, the tribe challenged an Eleventh Circuit decision that held that the Eleventh Amendment barred the tribe's suit against the state of Florida. The basis of the tribe's suit was the Indian Gaming Regulatory Act, which was passed by Congress pursuant to the Indian Commerce Clause in Article I. The Supreme Court held that the Indian Commerce Clause did not grant Congress the power to abrogate the state's Eleventh Amendment immunity.

Also in Seminole Tribe, the Supreme Court overruled its earlier decision in *Pennsylvania v. Union Gas*, 491 U.S. 1 (1989). In *Union Gas*, the Supreme Court had ruled that Congress had the authority to abrogate a state's immunity through another Article I power, the Commerce Clause. Thus, TSAC argues that since neither the Article I Indian Commerce Clause, nor the Article I Interstate Commerce Clause authorizes Congress to abrogate a state's sovereign immunity, the Article I Bankruptcy Clause can fair no better. Notably, all three clauses are Article I powers, and must be uniformly treated. Article I powers cannot be used to circumvent the constitutional limitations placed upon federal jurisdiction. Article III is the primary province of federal court jurisdiction, not Article I.

Article I's Bankruptcy Clause has a uniformity requirement. Respondent Hood claims that the constitutional requirement of uniformity reflects the Framers' belief that exclusive power over bankruptcy was surrendered to the federal government. TSAC maintains that the fact that a law must be "uniform" does not provide any greater federal authority than other Article I powers. The Constitution's reference to "uniformity" is presumably meant to show that Congress must have "complete" or "exclusive" authority to make laws in regards to that subject, or else there would not be a single, "uniform" law.

However, in petitioner's view, one cannot equate broad federal legislative authority with an equally broad federal right to abrogate a state's

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immunity. The argument is simply a non sequitur. Leaving aside the residual state legislative authority that exists with respect to insolvency, the lack of state legislative authority is irrelevant under *Seminole Tribe*. No matter how complete or exclusive—or "uniform"—the Article I lawmaking powers, they do not override state sovereign immunity, unless *Seminole Tribe* is to be overruled. The respondent cannot avoid the impact of *Seminole Tribe* by simply recasting a discussion about "plenary" powers into one about "uniform" powers.

TSAC further notes that to suggest that the "uniformity" requirement confers exclusive power upon Congress to establish a perfectly uniform system of bankruptcy at the expense of all rights of state sovereignty is at odds with experience. The "uniformity" requirement is simply a geographic requirement, and nothing more. The reality that bankruptcy law is not fully dictated by federal law, nor, indeed, is overly uniform is easily demonstrated. A bankruptcy law may be "uniform" even though it incorporates state law so that there are different results in different states. The current Bankruptcy Code uses state law to determine the "property" rights that go into the "property of the estate." Also, under 11 U.S.C. § 522(b), state law may require—to the total exclusion of federal law—that state laws decide what comes out of the estate as exemptions.

The "basic federal rule" in bankruptcy is that state law governs the substance of claims and the burden of proof required. Similarly, the determination of property interests in the assets of an estate is made under state law. Also, the Bankruptcy Code does not create a federal right of setoff, but, instead, generally preserves existing setoff rights created under state law. Nor does the uniformity provision forbid Congress from distinguishing between different classes of debtors, different industries, or different creditors. The uniformity requirement of the Bankruptcy Clause is not an Equal Protection Clause for bankrupts. Certain entities, such as insurance companies and most banks are not permitted to file for bankruptcy protection. There are special chapters for family farmers and municipalities. Railroads are not permitted to file under Chapter 7, but may file under Chapter 11. Also, there are many areas in which the Bankruptcy Code treats governmental units differently from the way it treats other creditors. Taxes, for instance, receive priority under § 507(a)(8), but tax liens can be subordinated to priority creditors in § 724(b) and, under § 505, debtors have special rights to relitigate tax claims. Similarly, there is a police and regulatory exception in § 362(b)(4) to the portion of the automatic stay set out in § 362(a), and governmental entities are subject to special antidiscrimination provisions in § 525 to which there is no police and regulatory exception. And, as pertains to this case, Congress has repeatedly tightened the limits on when debtors may discharge student loans that were made, insured, or guaranteed by a governmental unit. These are but a mere sampling that bankruptcy law is permeated in every aspect with state law considerations rather than being a system rigidly dictated solely by federal law.

In sum, the "uniformity" provision of the Bankruptcy Clause does not automatically preempt the entire field of bankruptcy, does not nullify all state laws on the subject, does not require that identical laws governing debtor-creditor relationships must apply in every state, and does not require Congress to treat all classes of debtors, creditors, or debts the same. Clearly, the uniformity requirement is designed to preempt any conflicting state laws, but was not intended to abrogate a state's immunity. In fact, a bankruptcy system that uniformly observes the sovereign immunity of the states would be constitutionally "uniform."

Finally, even if the Bankruptcy Clause did require strict, literal uniformity, such federal power would not eliminate the state's immunity from private actions. The Patent Clause, also an Article I clause, demands a uniform system of exclusively federal law to secure for authors and inventors the exclusive right to their respective writings and discoveries. Yet the Supreme Court has already held that, despite the need for uniformity, Article I of the Constitution did not divest the states of immunity from private-party suits in the areas of patent and trademark law. Similarly, the Court rejected the argument that the constitutional necessity of uniformity in the regulation of maritime commerce overrides the states' legislative sovereignty in the face of the federal government's regulation authority on that subject. In the petitioner's view, the arguments are no stronger for the conclusion that the "uniformity" requirement in the Bankruptcy Clause is sufficient to override the states' retained sovereign immunity. The Supreme Court has ruled that there must be "compelling evidence" of an intention to override the states' immunity in order to justify a finding that Congress has the power to do so. If such evidence does not exist, there can be no finding that the states waived their immunity so as to allow Congress to abrogate it by legislative action. There is no legal or factual basis for treating the Bankruptcy Clause any differently than the Commerce Clause, the

Patent Clause, or other Article I powers. According to the petitioner, the states retain their inherent sovereign immunity from private-party suits in the field of bankruptcy.

Respondent Hood maintains that the historical record reflects the surrender of the sovereign immunity of the states under the Bankruptcy Clause. The impetus for the Bankruptcy Clause in the Constitution arose from the economy's need for enhanced debtor/creditor laws. Creditors needed a better collective mechanism for the recovery of their claims, and entrepreneurs needed enhanced protection from the greater risks of failure presented by the changing economy. Merchants and traders who suffered major reverses were unwilling to settle with their creditors unless they knew their debts would be discharged upon the relinquishment of all their property. Disparate bankruptcy and insolvency laws among the different states were viewed as a major impediment to commerce.

The significance of debtor/creditor issues, including states' immunity, was reflected in numerous references in The Federalist papers. The Federalist No. 81, a primary authority for understanding Eleventh Amendment immunity, states in pertinent part:

> It is inherent in the nature of sovereignty, not to be amenable to the suit of an individual without its consent. This exception, as one of the attributes of sovereignty, is now enjoyed by the government of every state in the union. Unless therefore, there is a surrender of this immunity in the plan of the convention, it will remain with the states.

Hamilton explicitly qualified his description of the breadth of sovereign immunity in The Federalist No. 81 by the limitations on sovereignty described in The Federalist No. 32. Included in those limitations are areas, such as bankruptcy, in which Congress is granted the power to make uniform laws. TSAC argues that as The Federalist No. 32 addresses the issue of state sovereignty, while The Federalist No. 81 addresses a sovereign's immunity to suit, the limitations on state sovereignty identified in The Federalist No. 32 are inapplicable to the discussion of state sovereign immunity in The Federalist No. 81.

In Hood's view, such an argument simply ignores the clear intent of Hamilton in making explicit reference to The Federalist No. 32 in The Federalist No. 81. Rather than being a distinct and unrelated doctrine, sovereign immunity has been viewed by the Supreme Court as "a fundamental aspect" of state sovereignty. Accordingly, it is unsurprising that Hamilton referred his readers to The Federalist No. 32 rather than providing a separate discussion of the limits being placed on a state's sovereign immunity in The Federalist No. 81. Contrary to the claims of the states, the surrender of a state's legislative sovereignty with respect to the enactment of bankruptcy laws was not enough. In order for a national bankruptcy law to function, states also had to relinquish their sovereign immunity in the operation of those laws. Ultimately, of course, in addressing the Eleventh Amendment immunity of the states, the importance of The Federalist history is to make clear that the immunity exists today by constitutional design. Thus, it is in the language of the Bankruptcy Clause and the operation of the bankruptcy system that the abrogation of a state's sovereign immunity is most apparent.

Respondent further asserts that the uniformity requirement of the Bankruptcy Clause requires the abrogation of a state's Eleventh Amendment immunity. The Supreme Court has stated that the power to pass uniform bankruptcy laws was intended by the authors of the Constitution to be exclusive in Congress, or, at least, that they expected the power vested in that body would be exercised so as to prevent its exercise by the states. The references to uniformity and exclusivity reflect the Supreme Court's understanding that the Framers believed that the bankruptcy power had been fully surrendered to the national government. The surrender of the bankruptcy power would include all aspects of sovereignty, including state legislation and immunity.

Hood argues that the collective nature of a bankruptcy requires jurisdiction over a state. An inherent conflict exists between the Eleventh Amendment and the collective nature of a bankruptcy. The Eleventh Amendment bars a court from asserting jurisdiction over a nonconsenting state. A state's assertion of its Eleventh Amendment rights, therefore, strikes at the heart of the bankruptcy system. In essence, bankruptcy entails bringing all of the debtor's property into one forum, dividing that property among all who can demonstrate a lawful claim to it under the Bankruptcy Code, and allowing the debtor to continue its existence relieved of that burden. States are major players in that system. Actions in bankruptcy are not simply individual suits against a state. Instead, they are part of a collective process in which all creditors of a debtor, including very often the federal government, have an interest.

The collective nature of a bankruptcy necessarily alters a state's ability to assert its sovereign immunity.

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The assertion of a state's sovereign immunity can be particularly harmful. For example, if the state had a lien on a bankrupt debtor's property but was not made a party to the bankruptcy, it could wait until the bankruptcy case had concluded and then bring a foreclosure action in state court to fully recover its debt. Thus, unlike other creditors, a state would be able to avoid a bankruptcy and recover its claim after the financial strength of the debtor has been restored by the sacrifices that other creditors had been forced to bear in the bankruptcy case. The case law is replete with recent examples of states using their sovereign immunity to thwart the bankruptcy process at its most elemental level. In sum, if a state were free to exercise its sovereign immunity in bankruptcy, it would be able to use this power, not as a means of protecting itself, but as a mechanism for gaining an unfair advantage at the expense of other creditors, as well as the debtor. Without the consent of a state, a bankruptcy court would not have the required jurisdiction to alter a state's legal rights. According to Hood, case law illustrates the dangers that would arise from a blanket assertion of a state's sovereign immunity in bankruptcy and in this case the state has failed to demonstrate how these dangers can be avoided.

Finally, respondent asserts that in the absence of a hearing in bankruptcy court, the states have failed to provide any viable alternative means for the discharge of a student loan. State courts do not provide a viable alternative because a state is protected by the Eleventh Amendment from the adjudication of a federal cause of action in its own courts without its consent. Although TSAC argues that respondent can wait until the state initiates a collection action and at that juncture raise undue hardship as a defense, such a course of action would leave a debtor without its most basic entitlement under the Bankruptcy Code—a fresh start—as a state could wait for years before commencing a collection action. Most importantly, the student loan system is organized in a manner that avoids the need for commencing a collection action in state court. Instead, a student's wages may be garnished without court authorization. In fact, the applicable regulations bar a collection action when wage garnishment is a viable alternative. In addition, a debtor's tax refunds may be intercepted to obtain repayment of a student loan. In sum, an essential function of the bankruptcy system—the discharge of a student loan—may not be available if it is dependent upon access to state courts. In Hood's view, the absence of a viable state court remedy highlights one of the most troublesome aspects of upholding a state's Eleventh Amendment immunity in bankruptcy.

Significance

In a Republican form of government, the strength of each sovereign's immunity is critical. The Eleventh Amendment was created to protect each state's sovereign immunity. The Federalist papers indicated that a state's immunity is inviolate unless the immunity has been surrendered in the Constitution. In other words, for Congress to abrogate a state's immunity, it must be pursuant to a valid exercise of power under the Constitution. The Supreme Court had found authority to abrogate a state's sovereign immunity under the Fourteenth Amendment.

This case arises under the Bankruptcy Clause of Article I. In the passage of the Bankruptcy Code, Congress abrogated states' sovereign immunity, and made each state amenable to suit in federal bankruptcy court. To date however, the Supreme Court has not found any Article I powers sufficient to abrogate a state's sovereign immunity. The Court has considered cases under the Indian Commerce Clause, the Commerce Clause, and the Patent Clause, all Article I powers. This case will tell us whether the Article I Bankruptcy Clause is sufficient authority to abrogate a state's sovereign immunity.

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